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Dissolving a Company in Vietnam—Tax Considerations

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In recent years, the changing global economy, disruption of supply chains, and the consequences of the Covid-19 pandemic have created a heavy burden on businesses around the world. Many businesses have temporarily stopped operations, while others have gone bankrupt, dissolved or downsized their activities.

Vietnamese businesses, especially small and medium-sized enterprises, are no exception to this trend: Over 87% of enterprises were negatively affected by the Covid-19 pandemic. In early 2021, statistics showed that across Vietnam there were nearly 79,700 enterprises temporarily suspending business, ceasing operation awaiting dissolution, and completing dissolution procedures. On average, nearly 11,400 enterprises are dissolved every month: The most affected sectors are the garment, information and communication, electrical equipment manufacturing, and motor vehicle manufacturing industries.

Financial challenges and a lack of liquidity during the Covid-19 pandemic can lead investors to close a company's operations to cut losses, or restructure their business model, shutting down one or more of the group's business units which are affected and no longer viable.

In disposing of the business, or restructuring to shut down a business segment, in addition to the obligations to debtors and employees and the legal requirements, the finalization of tax obligations with the local tax authorities may also be an important concern—for example, where an enterprise may have an incorrect tax return or have applied inappropriate tax incentives/treatment, this might trigger challenges from the tax office.

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Although tax obligation clearance with the tax authorities is one of the necessary steps in closing a business, it is worth paying attention to current potential tax obligations, as well as remedial tax arrangements, to reduce the company's exposure, which might be detrimental to cash flow.

We describe below some tax issues relating to the dissolution of a business.

Additional Tax Obligations on Tax Audit for Closure

Assessment of current tax compliance status before a tax audit is highly encouraged to ensure that current tax filings and payments comply with the relevant tax laws. The following are some points that companies should take into account when carrying out tax audits for closure:

- Submission deadline for declaration for closure: Within 45 days from the closure date specified on the notification of company termination to the licensing bodies, the corporate income tax (CIT), personal income tax (PIT) (where applicable) finalization returns and invoice usage report are required to be submitted to the tax authorities, and relevant tax liabilities must be remitted to the state. For value-added tax (VAT), enterprises need to clearly determine the creditable VAT position payable or refundable in order to take the best approach, such as requesting a VAT refund or carrying forward to a new business entity.

- Late interest on tax payment: The rate of 0.03% per day is charged on unpaid tax liabilities counted from the day following the deadline for submission of tax declaration to the actual remittance date.

■ Administrative violation penalties and potential tax exposure if the tax officer identifies the taxpayers as carrying out inappropriate tax filing, in particular:

- ■ in the case of under-declared tax obligations, the administrative penalty for incorrect tax filing is from 5 million ($220) to 8 million Vietnamese dong (Clause 3, Article 12 of Decree No.125/2020/TT-BTC of Oct. 19, 2020);

- ■ in the case of tax fraud/evasion, administrative penalties imposed of 20% (Clause 1c, Article 16 of Decree No.125/2020/TT-BTC) or 1–3 times (Article 17 of Decree No.125/2020/TT-BTC) the evaded tax obligations; and

- ■ late payment interest at the rate of 0.03% per day (Clause 2a of Article 59 of Law on Tax Administration No. 38/2019/QH14 dated June 13, 2019) on outstanding tax obligations.

Key Tax Risk Areas

Many businesses may have outstanding tax debts or obligations of which they are unaware, or haven't resolved, upon ceasing operations, so having a detailed exit plan is highly recommended to mitigate the tax risks. Reviewing common tax issues is a practical strategy in identifying suitable solutions before requesting that the tax authority finalize the tax obligations of the business.

Non-settled outstanding payables are one of the most common major CIT exposures applying to enterprises that are going out of business or restructuring. A plan for paying/clearance of debts to employees, creditors, and tax authorities can reduce the tax risks in relation to its being deemed as other taxable income by tax authorities.

Liquidating the assets and trying to dispose of them at the best possible price is essential when deciding to close down a company. The enterprise is also required to issue and store output invoices for disposal transactions for the purpose of tax returns. The assets not disposed of should be written off with sufficient documentation to support the tax-deductible expenses for CIT finalization.

Reconciliation of cash in bank/cash on hand versus the cash ledger is necessary; disparity in monetary value raised in the tax audit procedure would be treated as other income.

The preparation of financial statements and CIT finalization return should be done on a non-going-concern basis.

Common Areas for Challenge by Tax Authorities

Understanding the trends of tax audits and specific risky areas for your business situation can create a way forward in preventing tax risk. In particular, the common tax areas which might be challenged by the tax authorities could be summarized as below.

Corporate Income Tax

■ Incorrect CIT incentives applied for new projects and expansion projects (tax exemption/reduction and preferential tax rate);

■ Offset profit and loss between business activities and losses carried forward;

■ Inter-company services expenses (e.g., re-charged management fees, shared cost, services fees, etc.);

■ Technology transfer, franchises, royalty required to be registered with Science and Technology Department, where applicable

■ Interest expenses for a company having transactions with related parties;

■ Inventory stock discrepancies after taking physical count, stock loss, damaged or expired inventories, etc.;

■ Provisions for and write-offs of bad debts;

■ Recognition of discounts/rebates/support; and,

■ Employment costs and other compensation costs due to laying off employees.

Value-Added Tax

■ Difference between revenue for VAT-able and CIT-able;

■ Incorrect allocation of input VAT corresponding to VAT-able and non-VAT-able revenue;

■ Input VAT on inventory stock discrepancies, stock loss, damaged or expired inventories;

■ Promotion campaigns without registrations/notifications to Department of Industry and Trade;

■ No output invoices issued for promotional goods/gifts; and,

■ VAT on discounts/ rebates/support programs.

Personal Income Tax

■ Under-declared onshore and offshore income sources of resident individuals and also benefit in kind/in cash paid to employees;

■ Wrong conversion of net income into gross income;

■ Wrong determination of housing benefits and non-taxable income;

■ Under-withheld PIT for income paid out to individuals; and,

■ Under-withheld PIT for the compensation paid to employees for termination of employment due to business restructuring plan/spin-off.

Foreign Contractor Tax

■ Determination of taxable revenues gained from supply of goods/goods with services which are delivered at bonded warehouse, inside or outside Vietnamese territory;

- Withholding tax on technology transfer fee, trademark fee or software attached to machinery; and
- Income generated from foreign contractors having or not having a permanent establishment or application of double taxation agreement exemption or reduction.

Transfer Pricing Issues

- Incorrect determination of exemption for disclosure of TP transaction, exemption for preparation of transfer pricing documentation report or insufficient declaration in TP form;
- Lack of TP documentation to provide to tax authorities upon the tax audit event;
- Un-adjusted TP charges/allocation due to the Covid-19 pandemic creating a different business situation compared to normal;
- Challenges on any TP documentation which is not prepared by the deadline for submission to the tax authority.

In the current difficult economic situation, any tax imposition also directly affects the enterprise's survival and short-term cash flow. Hence, understanding the tax audit process as well as important issues needing attention will help the business to reduce the risks of tax charges.

Planning Points

Enterprises should develop a clear strategy, detailed timeline and a strong dedicated team to work with the tax authority during the tax audit event.

Enterprises should periodically self-review to identify and assess key potential risk areas, estimate in advance the tax exposure, and have in place the proper action plans to minimize the tax risks.

In some cases, tax audit decisions are not appropriate and enterprises should consider developing a suitable plan for appeal to a higher level to obtain a correct assessment.

This article is of a general nature only and readers should obtain advice specific to their circumstances from professional advisers.

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